POLICY AND CAPITAL MARKETS
BRIEFING

CRE Finance Council
The Voice of Commercial Real Estate Finance

Policy and Capital Markets Briefing

By CREFC • Sep 26, 2022

Smart Brevity® count: 14 mins... 3676 words

CREFC's Policy and Capital Markets Briefing has a new look! While the layout has changed, we still aim to deliver the same insight and analysis that you have come to expect. Let us know what you think at info@crefc.org.

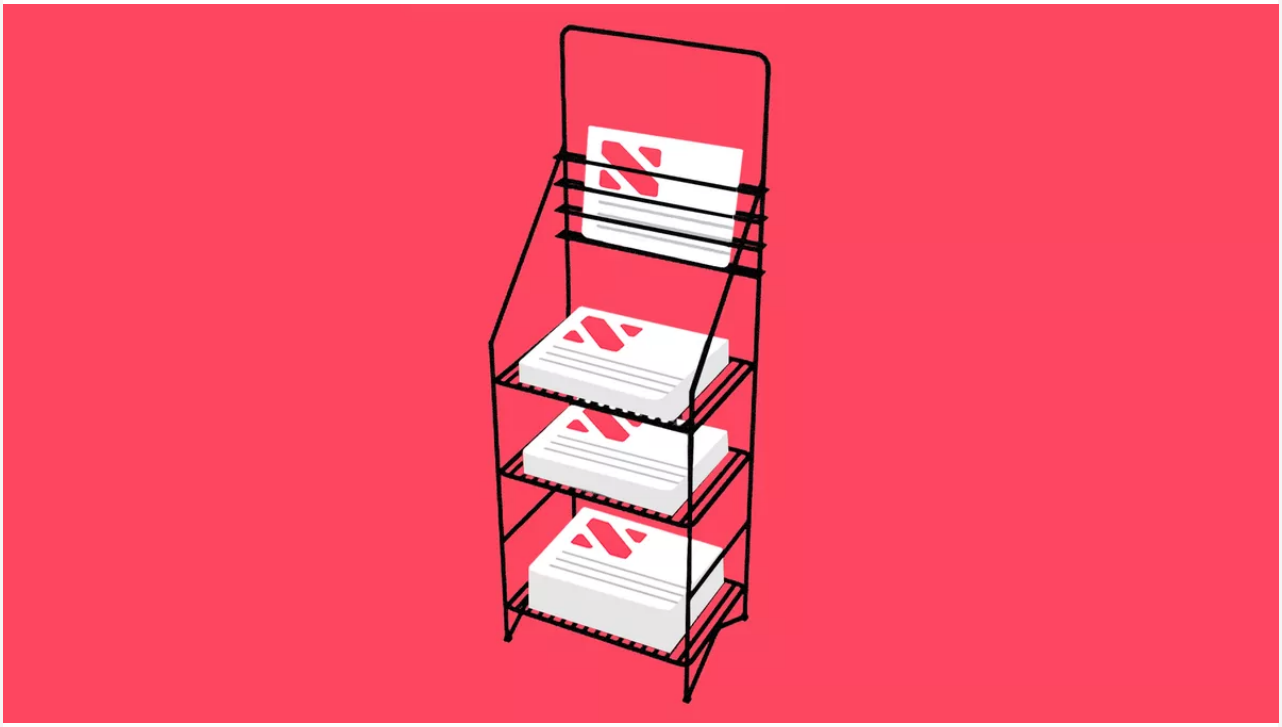
Quick Hits

CREFC's "Quick Hits" *summarize key news items of interest to the CRE Finance industry. Click the links to learn more.*

- Rents Drop for First Time in Two Years - Link
- House Financial Services Committee Chair Introduces Bill to Strengthen the CRA - Link
- Senator Toomey Requests Methodology from ESG Ratings Firms - Link
- Bank CEOs Warn US Economy at Risk from Inflation, Rate Hikes - Link
- Lessons Learned and Challenges Overcome When Building an ESG Platform from ESG Taskforce Team Lead Leah Fisher - Link

- Republican Members of the House Financial Services Committee Letter to SEC Chair Gary Gensler - Link
- CREFC Releases Compendium of Statistics for 2Q 2022 - Link

CRE Finance Council in the News



Last week, CRE Finance Council's David McCarthy was quoted in *Wealth Management's* story, "*How Are CRE Lenders Responding to the Fed's New Loan Workout Recommendations?*"

Our thought bubble: Responding to the Fed's proposed new loan workout, David is quoted as saying:

> *"If banks are able to make short-term accommodations without having to negatively classify or downgrade these loans on their books and take either a reserve or accounting hit on them, that could make it less costly to work out some of these temporary blips on the short-term accommodations," says McCarthy, who refers to it as a positive for both lenders and regulators.*

Go deeper: To read the full story, click here.

Trump Sued on Real Estate Valuations

On September 21, New York Attorney General Letitia James filed a suit against former President Donald Trump, the Trump Organization, and Trump family members for alleged fraud against lending institutions by overvaluing the company's real estate assets. James alleges the valuations put forward by the defendants were fraudulent and violated state and federal law.

Why it matters: While a suit against a former president is newsworthy, the accusations relating to valuation of real estate will bring the media spotlight (and commentary) on commercial real estate and the challenges

in valuing these assets.

By the numbers: AG James said that 11 of Trump's financial statements included more than 200 false and misleading asset valuations. The press releases highlighted several valuations the AG claimed were false:

- **Trump Tower Triplex:** Trump's personal residence was valued at $327 million or $29,738 per sq. foot in 2015. James alleges that nearly tripled the $100 million or $10,000 per sq. ft. record in New York.
- **40 Wall Street:** The complaint said Ladder Capital Finance approved a 2015 loan "based in part on an inflated appraisal" with a valuation of $540 million. A later 2015 Trump Organization statement valued the property at $735.4 million.
- **Mar-a-Lago:** The complaint notes the club was valued as high as $739 million, but the AG alleged that annual revenues of $25 million should have led to a $75 million valuation.

What's next: James' accusation will be tested as the case progresses. Trump has branded the suit as politically motivated.

Government Shutdown Unlikely But Down to the Wire

Permitting reform continues to hold up a Continuing Resolution (CR) to fund the government past Friday's fiscal year deadline. A test vote in the Senate on Tuesday will determine whether the CR includes permitting reform.

Why it matters: The government is at low risk of a shutdown, but lawmakers are down to the wire.

The big picture: Permitting reform supporters say the federal permitting process for both fossil fuel and renewable energy projects (like electric transmission) come with too much red tape under the National Environmental Policy Act, Clean Water Act, and Endangered Species Act.

This red tape prevents projects that create jobs, increase domestic energy production, and make the US energy-independent.

Yes, but: Reform opponents fear fewer and less robust environmental reviews, harming low-income communities of color who suffer from pollution by fossil fuel projects in their neighborhoods.

What's next: If the CR does not include permitting changes, lawmakers could add the provisions in a year-end omnibus spending bill or must-pass defense bill later this year.

Bank CEOs on Capitol Hill

Last week, the seven largest U.S. retail banks appeared in marathon hearings before the House Financial Services Committee and the Senate Banking Committee. The witnesses included CEOs of Bank of America, Citigroup, JPMorgan Chase, PNC, Truist, U.S. Bancorp, and Wells Fargo.

What they're saying: Overall, the hearings were a mix of bipartisan praise and criticism on a number of topics. Here are the topics most relevant for CREFC members:

- **ESG:** Some Republicans criticized climate goals and banks taking a position to reduce financing for oil and gas. Conversely, some progressives criticized banks for not divesting from certain industries, including fossil fuels. The CEOs emphasized their commitment to sustainability while continuing to engage in energy needs.

- **Climate Regulatory Reporting:** Ranking Member Pat Toomey (R-PA) questioned whether Congress authorized regulators to mandate climate reviews. While JPMorgan CEO Jamie Dimon said he personally did not think the Fed had that authority, he conceded the Fed could easily mandate banks to collect that. “They are my judge, my jury, and my hangman,” Dimon said.

- **Capital Requirements:** Several Republicans asked about whether capital and reserve levels were constraining lending. Several witnesses said that while their banks are very well capitalized, the impact of stress tests and the current expected credit loss (CECL) will limit the ability of banks to provide credit and liquidity.

- **Nonbanks:** The CEOs brought up the topic of nonbank financial institutions, including some of the possible regulatory arbitrage certain nonbanks have over regulated institutions (such as consumer mortgages). While they did not specifically urge for regulation in those spaces, they noted certain business activities need more oversight, such as when Zelle transactions are sent to nonbank accounts.

- **Diversity:** The banks highlighted their ongoing efforts to diversify their workforce and serve diverse customer bases. While some Democrats urged them to do more, House Financial Services Subcommittee on Diversity and Inclusion Chairwoman Joyce Beatty (D-OH) offered measured praise for the progress they have made.

The bottom line: Unlike hearings of the past, there were not calls for breaking up big banks. Rep. Pete Sessions (R-TX) was the most effusive in his praise:

> *I'm glad we've got big banks. I'm glad we've got stable people. I'm glad we have professionals that get up and go to work, take care of the free enterprise system, take care of large companies and small companies.*

CREFC's Policy Committee Discusses Industry's Priorities

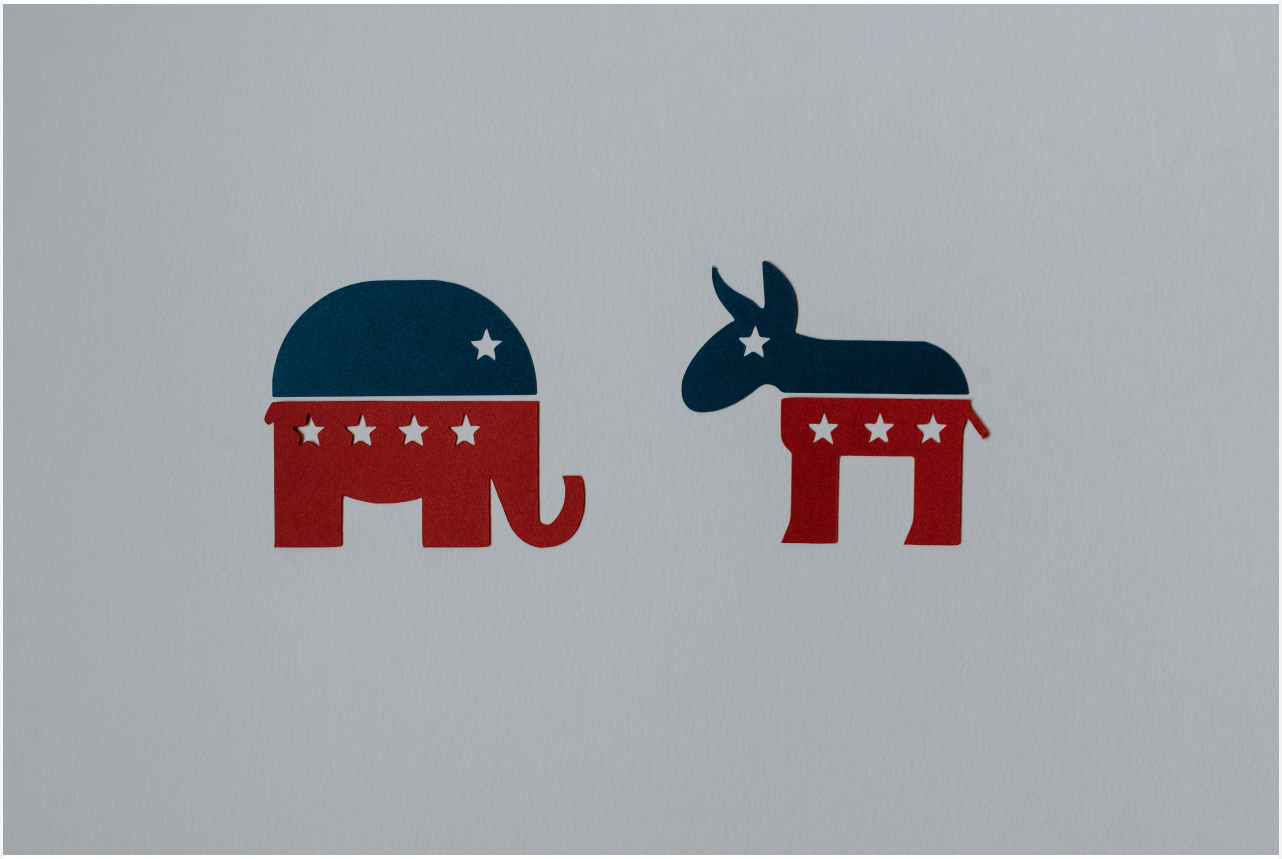
CREFC's Policy Committee met last week to discuss which issues the industry needs to get ahead of and issues that are impacting markets. Top of mind are:

- Interest rates,
- SOFR transition, and
- Stable sources of liquidity.

The committee also reviewed CREFC's Policy Forum Matrix, which shows which legislative and regulatory issues impact which Forums. Committee members expect to see SEC final climate disclosures soon, and are reviewing proposed updates by the FDIC, OCC, National Credit Union Association, and Fed on their Policy Statement on Commercial Real Estate Loan Accommodations and Workouts.

If you have issues, please reach out to the CREFC staff or your Forum leadership, and look each week in this newsletter for specific Forum updates that offer a deeper dive.

House Republicans Focus on Four Themes in 2023



Around 50 days before the midterms, House Republicans released their vision for the next Congress — 'Commitment to America.' Rather than a specific agenda, Republicans plan to focus on four themes if they win a House majority:

1. **The economy**, focused on **reducing inflation and energy costs** and strengthening supply chains
2. **Safety**, including reducing crime and securing the border;
3. **Freedom**, which relates to parental rights in schools and confronting big tech; and
4. **Government accountability**, "a nod to planned scrutiny of Biden administration officials," reports *The Wall Street Journal*, which notes:

> *Republicans will have the power to hold hearings and propose and pass legislation, but their ability to make new law will be limited—even if the party also takes the Senate. President Biden can veto bills, and many policies related to crime as well as school curriculum and transgender issues are controlled at the state or local level.*

Why it matters: To many Republicans, the platform feels like a turning point for their conference after four years stuck in the House minority, echoing their strongest campaign-trail points, *Politico* says.

Yes, but: President Joe Biden called the plan a "thin series of policy goals with little or no detail," while House Speaker Nancy Pelosi described it as an "alarming new extreme MAGA platform," citing the abortion stance and other parts of the proposal.

Go deeper: a one pager can be found here, and the above links provide more detail of the agenda.

November Outlook - McConnell's Cautious Optimism

With six weeks until the election, we have entered a period of constant conflicting messaging from political parties.

Last week, we covered the Democrat's mixed messaging. This week, Sen. Mitch McConnell (R-KY) has expressed publicly that he is optimistic about Republicans' chances.

Why it matters: After weeks of downplaying expectations for winning the majority and infighting between Senate Republicans, it's a surprising change of tone from the Minority Leader. During an event with the U.S. Chamber of Commerce, McConnell said he believes Republicans will retake the majority, but expects a close election.

Why is this important: McConnell's optimism comes as a result of Democrats' recent momentum slowing as:

- Inflation continues to be an issue and isn't slowing down.

- The Fed's aggressive rate hikes; raised rates again by ¾ point last week to combat inflation.
- GOP candidates in Georgia and Nevada are performing better than expected — neck and neck — with their incumbent Democratic opponents.

Bottom line: The GOP could be in the perfect spot to pick up one seat to win the majority.

Senate Election Outlook - Georgia & Pennsylvania

The 2022 general election is in full swing. In the coming weeks, we'll be covering the most important races to watch this November as Democrats and Republicans compete across the country.

This week, we're focusing on the Senate Races in Georgia and Pennsylvania.

Georgia —

- Senator Raphael Warnock (D) is statically tied with Heisman trophy winner and Republican candidate Herschel Walker according to the latest *Atlanta Journal-Constitution/University of Georgia* poll.
- While they may be tied in polling, they are not when it comes to fundraising. Warnock has $22 million in his war chest to get through this fall. Walker trails behind with $6.7 million.

Pennsylvania —

- Democratic nominee and current Lt. Governor John Fetterman has a 9-point lead over the Republican Candidate Dr. Mehmet Oz according to recent polling from *FiveThirtyEight*.
- Fetterman is also leading in fundraising with $5.4 million heading into the fall. Oz follows behind with $1.1 million after an expensive primary.

Why it matters: Polls and fundraising are two important factors to watch. With the narrow majorities in the Senate, both Democrats and Republicans are fiercely competing for voters.

SEC Investor Advisory Committee Recommends More Climate Risk Disclosure

On September 21, the SEC's Investor Advisory Committee (IAC) shared its support of the SEC's May 2022 climate risk disclosure proposal and recommended a couple of additional disclosures. *(The IAC is not part of the SEC. It was established by Dodd-Frank to advise the SEC on a variety of topics, including the effectiveness of disclosure and initiatives related to investor protection. Please see here for current IAC members.)*

In addition to encouraging the use of the Task Force on Climate-Related Financial Disclosures (TCFD) framework and the GHG Protocol, the IAC supports requiring:

- **Disclosure of Scope 1 and Scope 2 greenhouse gas** (GHG) emissions, and disclosure by large companies of material Scope 3 GHG emissions;
- **Attestation report** for accelerated and large accelerated filers at the reasonable assurance level for Scope 1 and Scope 2 emissions;
- **Disclosure of climate-related risks and impacts** on business strategy, model, and outlook;

- **Disclosure of risk management**, targets, and goals; and the
- **Presentation of disclosures** in financial statements.

The IAC also recommends that companies:

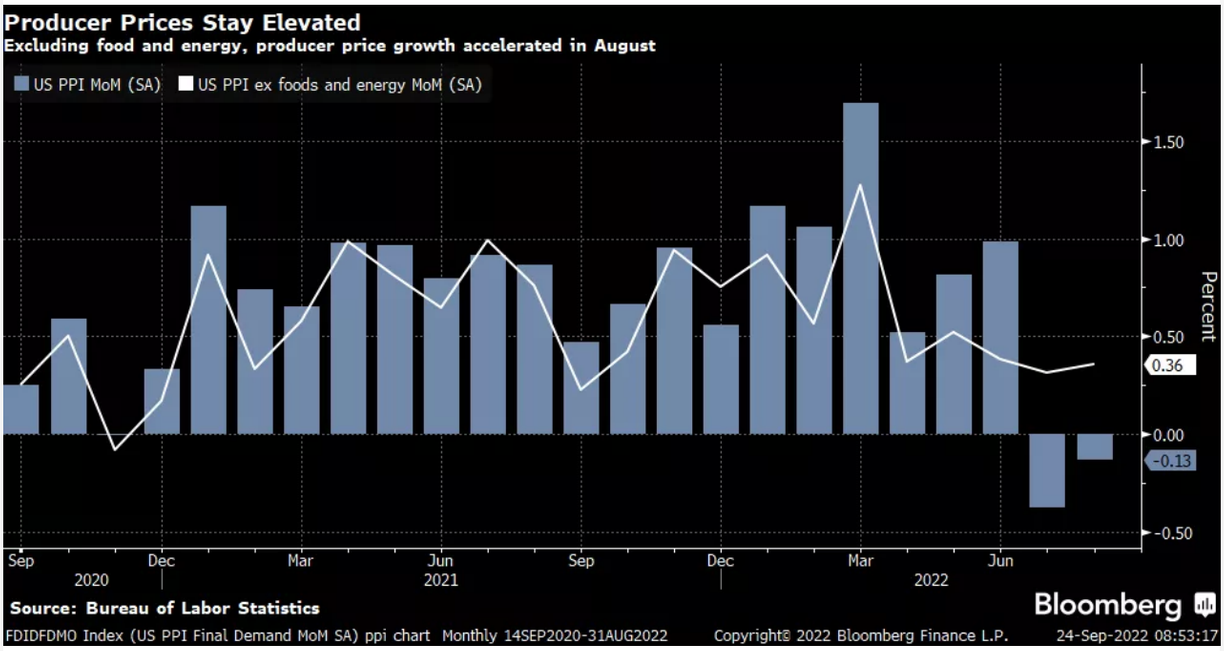
- Provide a "Management Discussion of Climate-Related Risks and Opportunities" in the annual 10-K. (This information need not be audited or subject to internal controls over financial reporting); and
- Disclose material facility locations, including owned facilities and facilities used by key suppliers.

What's next: According to the SEC's agenda, the climate disclosure rules will be finalized in October 2022, although market participants believe this deadline might slip.

- The SEC has received tremendous pushback from many parties, including several key Republican lawmakers, and will likely faces a slew of lawsuits upon the publication of the final rule.
- However, it is hard to gauge how much SEC Chair Gary Gensler will pull back on the proposed requirements.
- At a recent Senate Banking Committee oversight hearing, he stayed the course on some of the more controversial elements, including GHG emissions reporting requirements.
- CREFC will keep you apprised of any developments.

Please click here for CREFC's response to the climate disclosure proposal and contact sburki@crefc.org with any questions.

Headline August PPI Decreases But Core Prices Still Running Hot



The producer price index (PPI), which tracks the prices that businesses receive for their goods and services, declined 0.1% in August from a month earlier, according to data released by the US Bureau of Labor Statistics (BLS).

- That was consistent with analysts' expectations and follows July's revised 0.4% decline in prices.
- On an annual basis, the PPI rose 8.7% in August, down from 9.8% in July, and lower than economists' expectations of an 8.8% rise. However, an 8.7% reading is still extremely high and unlikely to dissuade the Fed to slow or cease raising rates.
- According to the BLS, lower fuel costs drove more than three-quarters of the decline in August.

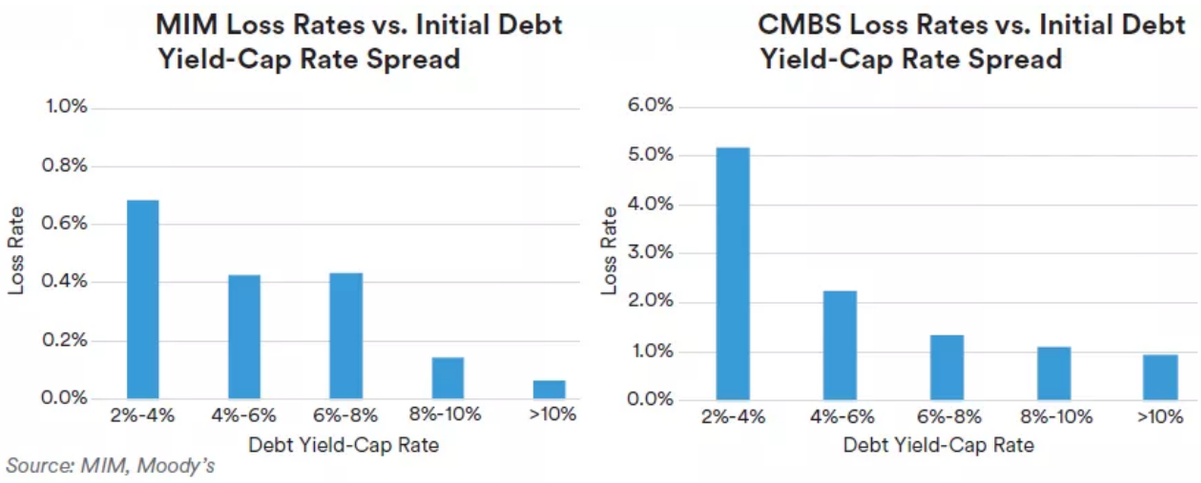
However, excluding the volatile food and energy components, core PPI increased by 0.4% in August, following an upwardly revised 0.3% rise in July. The year-over-year change came in stronger than expected at 7.3%, down from 7.7% the previous month and the peak of 9.7% in March.

Services prices, which comprise about 65% of the PPI, advanced at 0.4% in August, the most in three months and the fourth consecutive increase. While most of the growth was attributed to margins for fuel and lubricant retailing, prices for securities brokerage, investment advice, and loan services also increased.

According to a note by Eliza Winger, an economist for *Bloomberg*, goods inflation should moderate amid cooling demand. Still, producers

are contending with intense wage pressures, especially in labor-intensive industries. She cited a New York Fed study which showed a 10% increase in import prices and wages last year was associated with a 7.4% increase in producer prices, compared to only 3% in the prior year. "The [PPI] report adds to concerns about a potential wage-price spiral within services, likely keeping the Fed hiking rates through the first half of 2023."

New MetLife Study Looks at Historical Performance of Commercial Mortgages



Source: MIM, Moody's

On September 20, MetLife Investment Management (MIM) published a report which examined the longest-known dataset of commercial mortgage loan performance, ranging from 1957 – 2021. The report is an update and expansion of a 2005 report, "Case Study of Leverage and Default Risk over a Full Real Estate Cycle," published by Moody's and based largely on MIM's commercial mortgage-portfolio history.

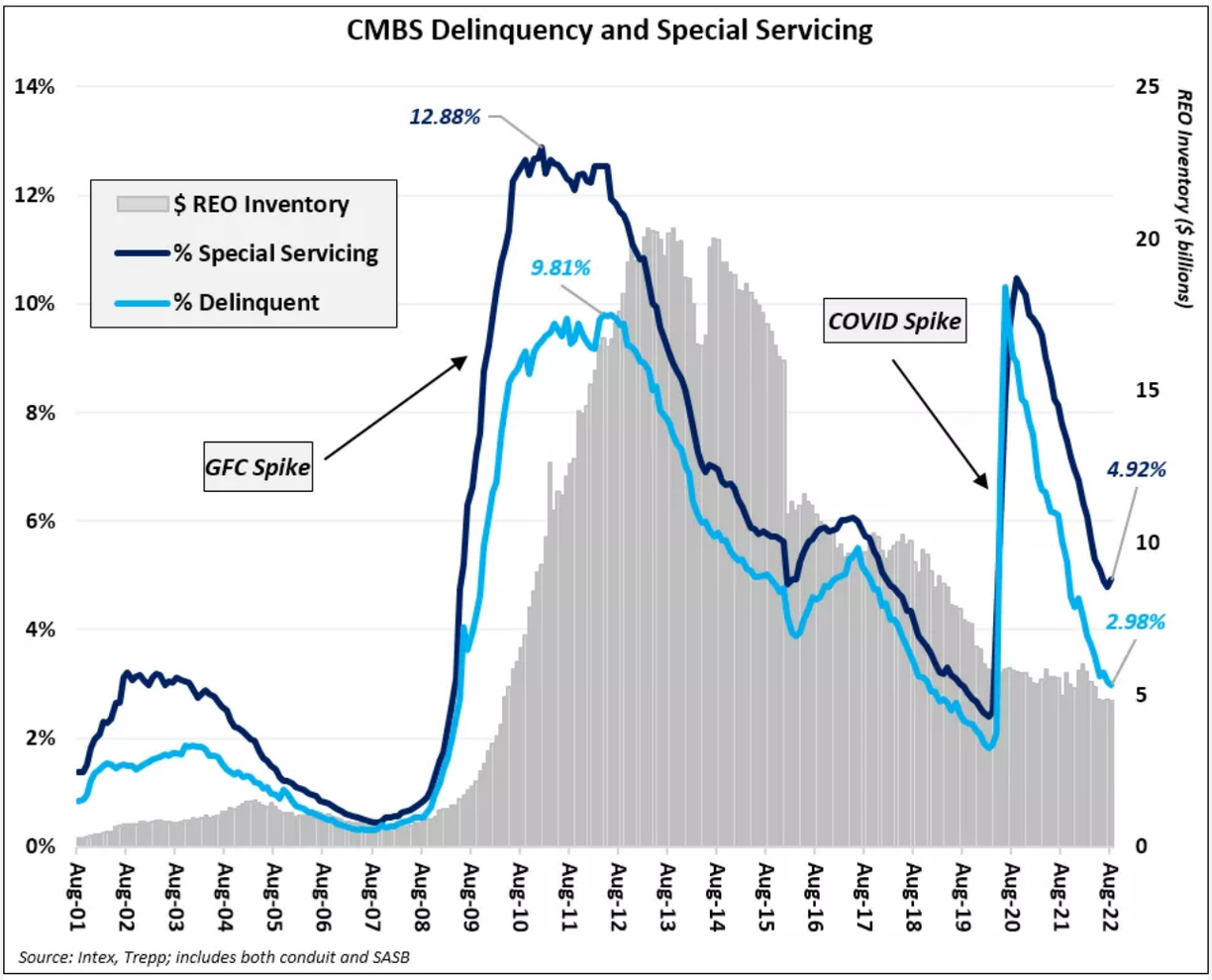
Like its previous study, the current analysis showed that while the position in the economic cycle when a loan is underwritten is important, the critical factor is LTV. The analysis shows, not surprisingly, that loss rates from higher-leverage loans can increase substantially if underwritten late in an economic cycle. In contrast, loans with more conservative leverage ratios present similar levels of risk no matter when in the cycle they are underwritten.

Besides LTV, the report looks at other underwriting metrics, specifically DSCR and debt yield. The authors note that DSCRs can be deceptive as longer payback periods or lower interest rates can produce

higher DSCRs that are not truly indicative of the loan's risk profile if there is a market downturn and/or a foreclosure. Debt yield, however, can be a more meaningful measure than DSCR in some instances and offers a lender a more standardized view of risk as it indicates potential returns if the lender had to take possession of the property.

The study then examines the relationship between debt yield and cap rates and concludes that the relationship between the two is a more effective tool for mitigating losses. The authors' analysis shows that loans with smaller differentials between debt yields and cap rates have higher loss rates. As a result, the report concludes that lenders should look at the debt yield relative to cap rates to better gauge losses across a range of economic environments and lender-risk profiles than debt yield alone.

CMBS Delinquency Rate Drops Below 3%



- Following a 15 basis point decline in July, the CMBS delinquency rate fell eight basis points (bps) in August to 2.98%. This marks the first time since the start of the pandemic that the rate was below 3%.

- Loans in special servicing, however, rose 12 bps in August to 4.92%, marking the first increase after 22 consecutive monthly declines. Nonetheless, the rate remains well below its high of 10.48% in September 2020. Retail and multifamily loans drove the increase, rising 114 and 67 bps to 11.03% and 1.90%, respectively. All other property types saw decreases.

- While too early to declare a trend, the uptick in the special serving rate in August may reflect the challenges of refinancing loans in the current rate and economic environment. We anticipate some increase in loans transferred to special servicing in the coming months.

CREFC Capital Markets Update

Category	Benchmark	9/23/2022	1 Week Prior	1 Year Prior
Rates	2-Year Treasury	4.20%	3.87%	0.26%
	10-Year Treasury	3.68%	3.45%	1.43%
	2-Year / 10-Year Treasury Spread	-0.52%	-0.42%	1.17%
	1-Month LIBOR	3.08%	3.01%	0.09%
	3-Month LIBOR	3.64%	3.57%	0.13%
	30-Day Average SOFR	2.30%	2.28%	0.05%
	1-Month Term SOFR	3.03%	3.02%	0.05%
	SOFR Volume (billions)	$1,023	$952	$878
	SOFR 3-Month Futures Open Interest (delayed)	7,913,559	7,478,513	774,822
Economic Data	Core CPI	6.30%	6.30%	4.00%
	Overall CPI	8.30%	8.30%	5.30%
	PPI	8.70%	8.70%	8.70%
	GDP	-0.60%	-0.60%	6.70%
	Initial Jobless Claims (thousands)	213	213	380
Equities	DJIA	29,590	30,822	34,765
	S&P 500	3,693	3,873	4,449
	Nasdaq	10,868	11,448	15,052
CMBS	10-Year New Issue CMBS AAA Spread to Treasuries (bps)	129	129	89
	10-Year New Issue CMBS BBB- Spread to Treasuries (bps)	575	575	353
	Private-Label CMBS & CRE CLO Issuance (YTD, millions)	**$88,716**	**$84,537**	**$98,346**
	Conduit	*$19,632*	*$18,356*	*$20,602*
	SASB	*$41,927*	*$41,400*	*$46,067*
	CRE CLO	*$27,157*	*$24,781*	*$31,677*
	Agency CMBS Issuance (YTD, millions)	**$113,786**	**$111,475**	**$130,177**
	Fannie (DUS, GeMS, MCRT)	*$38,277*	*$38,277*	*$41,917*
	Freddie (K, Multi PCs, SBL)	*$53,926*	*$51,742*	*$54,628*
	Ginnie (Project Loans)	*$21,583*	*$21,456*	*$33,632*
CRE Loans *(1-week lag)*	10-Year, 60-65% LTV, Spread to UST, Multifamily (bps)	194	192	148
	10-Year, 60-65% LTV, Spread to UST, Office (bps)	223	227	191
	10-Year, 60-65% LTV, Spread to UST, Retail (bps)	221	223	188
	10-Year, 60-65% LTV, Spread to UST, Industrial (bps)	200	201	155

Sources: Bloomberg, J.P. Morgan, BofA Global Research, Trepp

Heavy Issuance Week Across Private-Label and Agency Markets

- **Private-Label CMBS and CRE CLOs**. Four transactions (two SASB, one conduit, and one CRE CLO) totaling $4.2 billion priced last week. As of September 23, private-label CMBS and CRE CLO issuance stood at $88.7 billion, down 10% from the $98.3 billion for the same period in 2021.

- Following a solid first quarter this year, issuance slowed significantly, narrowing – and eventually eliminating – the year-over-year issuance margin. At the end of Q1 2022, total issuance was 70% ahead of the same period in 2021.

- According to *Barclays*, while this week's deal pipeline looks thin, multiple conduit and CRE CLO transactions are expected to hit the market in the coming weeks. However, as financing costs have become restrictive to some borrowers and deal collateral becomes harder to aggregate, we will likely see new issuance activity slow and not all planned transactions close as scheduled.

- Spreads on 10-year conduit super-senior AAA remained unchanged at 129 bps, likely as buyers of long-duration paper emerged. Spreads on AA – A also did not move, ending the week at 200 – 280 bps, respectively, as did BBB- spreads at 575 bps. Despite the lack of movement in spreads, the upward climb in Treasury rates is providing higher all-in yields to investors, allowing them to move up in the capital stack while still locking in attractive returns.

- Spreads on AAA SASB widened 2 – 5 bps last week to 150 – 190 bps, while senior AAA CRE CLO spreads widened 5 bps to 185 bps. SASB and CRE CLO have benefitted from increasing investor demand amidst higher short-term rates, with 1M SOFR at over 3% – compared to 0.5 – 0.10% at the start of the year.

- **Agency CMBS**. Issuance last week totaled $2.3 billion, consisting primarily of two Freddie K transactions. Total agency issuance reached $113.8 billion for the year-to-date period ended September 23, down 13% from last year's point ($130.2 billion).

- The GSEs may end the year falling short of their $78 billion lending cap. In addition to higher rates and reduced acquisition activity, the agencies have faced stiff competition from banks, debt funds, and life companies over the past year.

Issuer Forum Highlight

Together, David, Jane and Dan form the "Leadership Working Group" for the Issuers Forum set agendas and priorities for the forum, as well as represent the constituency on CREFC's Policy Committee.

Key Issuers Focus Areas

- Improving competitive positioning of securitized lenders, especially in light of significant interest rate and credit spread volatility
- Enhancing transparency within the CMBS market both pre- and post-securitization with a current emphasis on standardizing disclosure and reporting across the CRE CLO sector
- Maintaining open dialogue with other market participants to help promote responsible lending, including incorporating feedback on structural and documentation enhancements necessary to improve both the borrower experience and loan performance
- Balancing conduit pools to account for evolving investor preferences across property types and other credit concerns
- Ensuring that we proactively manage regulatory changes such as LIBOR transition and also retrospectively evaluate previously implemented regulatory measures such as risk retention to determine if any modifications would be beneficial

Looking ahead, leaders are concerned that recent volatility in rates and deteriorating capital markets conditions may disproportionately impact CMBS issuance in the near term. That said, we remain focused on improving transparency, liquidity, and performance to best position the sector to capitalize on opportunities and grow market share as conditions stabilize.

What's Next: Forum Leaders are planning a virtual forum wide legislative and regulatory policy update and will soon be formulating the agenda for CREFC's January Conference.

To join the Issuers Forum, please register here. For any forum related questions, please contact Kathleen Olin (kolin@crefc.org).

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